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THE BOLI PRIMER

WHAT IS BOLI?

Bank-Owned Life Insurance (BOLI) is used as a tax efficient method for offsetting the costs of employee benefit programs. The cash value growth in the policy is tax deferred (tax free if held until death) and the death benefits are tax-free. The policies insure the lives of key employees and/or bank directors.

WHY DO BANKS BUY BOLI?

The reasons for the popularity of BOLI financing are fairly straightforward:

- Tax-favored returns that exceed the after-tax returns of more traditional bank investments by 150 to 300 basis points
- Cash values grow tax-deferred (tax-free if held until death)
- Death benefits are tax-free
- Ability to efficiently generate gains to offset costs associated with employee benefits programs
- Products are institutionally priced and designed specifically for financial buyers
- Products are generally immediately accretive to earnings
- Risks that are within standard business risks in the bank's investment portfolio
- Well-defined guidance on permissible usage by regulatory authorities
- No surrender charges
- Diversifies investment portfolio
- Ability to immediately increase ROE and ROA

BOLI is a tax favored asset with returns that typically exceed after-tax returns of more traditional bank investments by 150 to 300 basis points.

HOW DOES BOLI WORK?

A bank purchases the life insurance with either a single premium, or a series of annual premiums, on a select group of key employees and/or bank directors. The bank is the owner and beneficiary, although many banks opt to share a portion of the insurance proceeds with the participants. The cash value growth within a BOLI policy produces a return greater than the opportunity cost, or what the bank would have made in an alternative investment and is used to offset the costs of employee benefit programs.

The accounting for BOLI is governed by FASB Technical Bulletin No. 85-4 and should be recorded on the balance sheet as "other assets." The increase in cash surrender value during a specific period, as well as the final net insurance proceeds at maturity, are recorded as "other income."

BOLI is a long-term asset and, when properly implemented and administered, offers the bank a highly rated investment option.

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BOLI RATE SPREADS

The following chart illustrates a hypothetical investment comparison between a hypothetical BOLI purchase and alternative investments.

	HYPOTHETICAL INVESTMENT COMPARISON				
	Fed Funds	5-Year Treasury	MBS Portfolio	Municipal Bonds	BOLI
	\$5,000,000	\$5,000,000	\$5,000,000	\$5,000,000	\$5,000,000
Yield	0.15%	0.85%	2.95%	2.20%	3.75%
Income	\$7,500	\$42,500	\$147,500	\$110,000	\$187,500
Tax (35%)	(2,625)	(14,875)	(51,625)	0	0
Net Income	4,875	27,625	95,875	110,000	187,500
TEFRA Disallow. (Est.)				4,445	
Net Income	\$4,875	\$27,625	\$95,875	\$105,555	\$187,500

BOLI FACT AND FIGURES

BOLI continues to be a popular investment choice for a variety of banks. As of November 30, 2011, over 3,700 banks nationwide reported BOLI cash surrender values on their regulatory filings. Almost 59% of banks nationwide with assets between \$100 million and \$1 billion currently own BOLI.

Asset Size	Total Banks	BANKS WITH BOLI		AVERAGES FOR BANKS WITH BOLI*		
		Number	Percent	Capital**	BOLI CSV	Percent BOLI to Capital
>\$10B	107	70	65.4%	\$21,427,930	\$2,417,762	11.3%
\$5-\$10B	62	41	66.1	756,732	101,478	13.4
\$1-\$5B	500	378	75.6	198,839	27,289	13.7
\$500M-\$1B	685	479	69.9	147,368	21,428	14.5
<\$500M	6,148	2,781	45.2	59,329	9,260	15.6
TOTALS	7,502	3,749	50.0%			

Data Source: SNL Financial Database as of 9/30/11.

*Numbers in thousands.

**Tier 1 Capital plus Loan Loss Allowance, if applicable.

RULES AND REGULATIONS

The Interagency Statement on the Purchase and Risk Management of Life Insurance (OCC 2004-56) provides general guidance for banks and savings associations regarding supervisory expectations for the purchase and risk management for bank owned life insurance (BOLI).

The Interagency Statement highlights the following supervisory guidance required before entering into a BOLI contract:

- Effective senior management and board oversight;
- Comprehensive policies and procedures, including appropriate limits;
- A thorough pre-purchase analysis of BOLI products; and
- An effective ongoing system of risk assessment, management, monitoring, and internal control processes, including appropriate internal audit and compliance frameworks.

This material is not intended to, and does not, present an opinion or advice with respect to accounting, legal, or tax matters. Please consult with your accountant, attorney, or tax advisor, as applicable.

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